



February 2014

Wealth Maximization Revisited

Richard A. Posner

Follow this and additional works at: <http://scholarship.law.nd.edu/ndjlepp>

Recommended Citation

Richard A. Posner, *Wealth Maximization Revisited*, 2 NOTRE DAME J.L. ETHICS & PUB. POL'Y 85 (1987).
Available at: <http://scholarship.law.nd.edu/ndjlepp/vol2/iss1/8>

This Article is brought to you for free and open access by the Notre Dame Journal of Law, Ethics & Public Policy at NDLScholarship. It has been accepted for inclusion in Notre Dame Journal of Law, Ethics & Public Policy by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.

ARTICLES

WEALTH MAXIMIZATION REVISITED

RICHARD A. POSNER*

Some years ago, I published an article in which I argued that "wealth maximization" provides an ethically attractive norm for social and political choices, such as those made by courts asked to determine whether negligence or strict liability should be the rule for deciding whether an injurer must compensate his victim.¹ This article gave rise to a flurry of criticisms,² to which I replied³—without convincing many of the critics.⁴ I am pleased to have this opportunity to reconsider my position. Perhaps as a result of my new perspective as a judge, I find myself slightly more sympathetic to some of the criticisms than I once was—but only slightly more.

I. WHAT IS WEALTH MAXIMIZATION AND WHERE DOES IT COME FROM?

To most people who are not economists, the word

* Judge, U.S. Court of Appeals for the Seventh Circuit; Senior Lecturer, University of Chicago Law School. This is the revised text of a lecture given at the Thomas J. White Center on Law & Government at Notre Dame Law School on September 5, 1985. I am grateful to Gary Becker, Jules Coleman, Frank Easterbrook, Steven Shavell, George Stigler, David Strauss, and Cass Sunstein for helpful comments on a previous draft. The reader is asked to grant the usual indulgences in reading a paper originally intended for oral delivery.

1. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103 (1979), which appears in slightly different form in R. POSNER, *THE ECONOMICS OF JUSTICE* ch. 3 (1981).

2. See, e.g., Coleman, *Efficiency, Utility and Wealth Maximization*, 8 HOFSTRA L. REV. 509 (1980); Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191 (1980); Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227 (1980); Weinrib, *Utilitarianism, Economics, and Legal Theory*, 30 U. TORONTO L.J. 307 (1980).

3. See R. POSNER, *supra* note 1, ch. 4; Posner, *A Reply to Some Recent Criticisms of the Economic Theory of the Common Law*, 9 HOFSTRA L. REV. 775, 786-94 (1981).

4. See, e.g., N. MERCURO & T. RYAN, *LAW, ECONOMICS AND PUBLIC POLICY* 130-37 (1984); Coleman, *The Normative Basis of Economic Analysis: A Critical Review of Richard Posner's The Economics of Justice* (Book Review), 34 STAN. L. REV. 1105 (1982).

"wealth" suggests money. But to an economist, it refers to weighting preferences for the things that people want, either by willingness to pay for a thing, if you do not own it, or by unwillingness to part with it voluntarily, if you do own it. So, if I am unwilling to part with my house for less than \$100,000, and no one is willing to pay more than \$90,000 for it, society's wealth is \$10,000 greater than it would be if the house were taken from me and given to the highest bidder (I am not a bidder, because I am the owner). This would be so even if I were paid \$100,000 for the house (which would require taxation, since no one will voluntarily pay \$100,000 for it). I would be no wealthier than before, and the rest of the community would have \$100,000 less, incompletely offset by a house worth only \$90,000 to its new owner.

Now suppose that I want a car and would pay \$10,000 for it, and the present owner would sell it for \$5,000. Society's wealth will be increased if I am allowed to buy the car from him for any amount between \$5,000 and \$10,000 (ignore selling costs). Suppose the price is \$7,500. After the transaction I will have \$2,500 plus a car worth \$10,000 to me. I will thus have total wealth (ignoring the house and any other wealth I have) of \$12,500, and he \$7,500, for a total of \$20,000, whereas before the transaction our combined wealth was only \$15,000.

Granted, both examples ignore a fundamental problem—how it is that I initially came to have the house, and he the car. I shall come back to that problem, but for now, I just want to explain what wealth means.

Wealth is not limited to market commodities such as houses and cars. As a matter of fact, the value of houses and cars is not always reducible to market values. The house I value at \$100,000 might not be valued at more than \$90,000 by anyone else because it has sentimental associations for me, and likewise with the car. In this case, the real value would exceed market value. Or, I might work for a lower salary than I could make, simply because I liked the work I did for that lower salary so much; that would mean that I derived part of my wealth from working and part from the pecuniary income that I earned by working.

These examples help to show that money, to an economist, is not wealth, but just a measure of one's entitlement to houses, cars, rewarding work, leisure, privacy, and countless other "things" that constitute a person's wealth; everyone's wealth added together constitutes the nation's wealth. The wealth of a nation is the present value of the flow of benefits,

measured as suggested above, from the consumption of goods and services, tangible and intangible, by its people. Monetary measures of social income or wealth⁵ such as Gross National Product or National Income are inadequate and inaccurate measures of a nation's wealth. When I used money as a component of wealth earlier, it was just a shorthand term for the things that money can buy.

The economist uses the concept of income or wealth in this broad sense all the time, but calls it "utility," meaning, however, something quite different from what utilitarian philosophers mean. To compound the confusion, the economist uses the word "wealth" to mean something different from the economic concept of "utility." To the economist, "utility" differs from "wealth" because utility is adjusted for people's preference for risk or (more commonly) aversion to risk, in the sense of the variance of possible outcomes of an uncertain event. If you were given gratis a fifty percent chance of winning ten dollars (and an equal chance of winning nothing), your "wealth" (in the narrow economic sense) would rise by five dollars, which is the expected utility of the chance to someone who is risk neutral. But if you were risk averse, the increment in your expected utility would be less than five dollars, so you would sell the ticket to someone less risk averse, or risk neutral, or risk preferring, if you could, and you would thereby increase your utility. If you were risk preferring, the chance would be worth more than five dollars to you. Thus "wealth," in my sense, is a synonym for expected utility. Bear in mind that wealth is a function of willingness to pay (or unwillingness to part with, but for present purposes, the difference is unimportant). If you will pay more for the fifty percent chance than its certain equivalent (because you are a risk preferrer), then it is worth more to you; its expected utility determines your willingness to pay, and hence describes the effect of the chance on your wealth. For example, if you would pay six dollars for the chance, the gift of it would increase your wealth by six dollars.

Wealth, in my sense, equates to utility in the economic sense but is distinct from the utilitarian concept of utility as happiness, however broadly (or narrowly) happiness is de-

5. "Income" is a flow concept, "wealth" the corresponding stock concept. The important thing to bear in mind is that income (and therefore wealth, which is the discounted present value of anticipated future income) refers to real rather than monetary phenomena—to housing or transportation services or leisure, not to wages or dividends.

finer, though wealth and happiness are positively correlated. (Ask anyone whether he or she would turn down an unconditional gift of money!) I might be made deliriously happy by being given a ticket to a Notre Dame football game, but if I am outbid by another football fan, it means that wealth maximization requires that I not get the ticket, even though the person who outbids me might derive less pleasure from the game than I would have derived. The refusal of modern economists to make "interpersonal comparisons of utility" means in effect that they use wealth rather than happiness as the criterion for an efficient allocation of resources.

People find it easier to picture wealth maximization in actual transactions than in potential transactions, but one of the most important uses of the concept is in connection with potential transactions. I refer to the analysis of the welfare loss (in my terminology, the wealth loss) caused by monopoly. In Figure 1, the monopolist, in order to increase his profits over the competitive (= zero) level, reduces his output to q_m , at which level the market-clearing price is p_m . Those customers who continue to buy the product at its new, monopoly price incur a wealth loss measured by the rectangle ABCF; but their loss is the monopolist's gain, so there is a wash. The

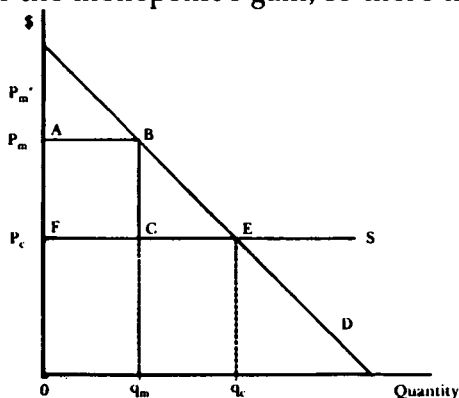


Figure 1

net social loss from monopoly is the triangle BEC. This is the consumer surplus that is lost by those who are deflected to substitute products by the higher price, but that is not transformed into producer surplus (profit). In what sense is it a loss? At the competitive price and output, these consumers (all but the last, represented by the intersection of D and S, at point E) would have been willing to pay more for the product than they were charged. In other words, the product increased their wealth by more than the purchase price—as is

still true of those consumers who continue to buy the product at its current price. The idea of consumer (and producer) surplus, a legacy of the great English economist Alfred Marshall, shows that wealth is not money. This is the crucial insight in making wealth maximization a standard of social welfare.

The welfare loss of monopoly is the least controversial, though no longer the only, ground on which economists denounce monopoly.⁶ This denunciation illustrates the normative use of the concept of wealth maximization,⁷ and my position in this paper amounts to nothing more than expanding the normative domain of the concept. If you think back to the house and car examples with which I began, you will realize that they were both cases where the objective was to maximize surplus value—the value that measures what people are willing to pay (or what they demand) over and above market price, the price paid by the marginal buyer (p_m' in Figure 1).

Anyone who is inclined to say that wealth is not a value in an ethical sense should ask himself whether he agrees that monopolies and cartels are bad because they lead to a reduction in the value of output. If he agrees with this traditional economic criticism, then he believes that wealth is a social, ethical value—whether he knows it or not. He also believes that interpersonal comparisons of wealth are possible—that is, that it is possible to compare the loss of surplus to the consumer with the gain to the monopolist. It is by such comparisons that one can determine whether a given transaction, policy or institution is wealth maximizing. Of course, the information costs may be formidable, but there is no objection in principle to measuring aggregate wealth.

II. CRITICISMS

The most basic criticism of an ethic of wealth maximization is one that I share: that you cannot deduce “ought” from “is”; you cannot prove, deductively or inductively, that

6. See, e.g., J. HIRSHLEIFER, PRICE THEORY AND APPLICATIONS 249-52 (1984).

7. And makes quite extraordinary the assertion that wealth maximization requires monopoly because monopoly leads to higher prices. See N. MERCURO & T. RYAN, *supra* note 4, at 132; Kornhauser, *A Guide to the Perplexed Claims of Efficiency in the Law*, 8 HOFSTRA L. REV. 591, 596-97 (1980); Coleman, *supra* note 2, at 523-24. This is known in the economic literature as the Earl of Lauderdale's fallacy. See G. STIGLER, THE THEORY OF PRICE 196-97 (3d ed. 1966).

social decisions ought to conform to some ethical theory. The lack of provability imparts a pervasive uncertainty to ethical debates; it is not clear what it means to prevail in an ethical argument. Ethical arguments do not convince doubters but rather provide rationalizations for ethical positions taken on emotional grounds. Indeed, more ethical arguments have been won on the battlefield than in the lecture hall; and if the fascist powers had won World War II, the dominant ethical views in this society would probably be different today. Perhaps—speaking descriptively and in the long run—might is responsible for most opinions of what is right.

My goal is therefore quite modest. I do not seek to “convert” anyone to wealth maximization. I merely want to persuade you that it is a reasonable, though not a demonstrably or a universally correct, ethic (I shall explain later why my goal is so limited). But to do this I shall have to consider the principal arguments against its being even that.

A. *Asking versus Offer Prices, and the Derivation of Property Rights*

The first argument is that the idea of wealth maximization does not tell us whether to maximize in terms of asking or offering prices; in my example of a house, the asking price was \$100,000 but the offer price was only \$90,000. I reject this argument. The concept of wealth maximization tells us when to use asking and when to use offer prices, provided—an important qualification to which I shall return in a moment—that property rights have been assigned.

If the costs of voluntary transactions are low, the equilibrium prices, which provide the logical and natural means of measuring wealth, will be asking prices; for whenever an offer price is higher than an asking price, the offer will be accepted.⁸ If the costs of voluntary transactions are prohibitive, however, then offer prices⁹ may exceed asking prices indefinitely; and if, but only if, an involuntary transaction is possible at a cost less than the difference between offer and asking price, the offer price (that is, the hypothetical offer price)

8. At the margin, of course, the offer and asking price will be the same; but there may be many intramarginal holders of the good or service transacted in the market, and for them the asking prices will exceed the offer prices and provide the correct measure of value. The house example illustrates this point.

9. Hypothetical offer prices, that is, if transactions are prohibitively costly, no one will bother to make offers.

rather than the asking price will provide the correct guide for social choices designed to maximize wealth. Suppose millions of people would be willing to pay in the aggregate \$1 billion for clean air, and the polluters would be willing to stop polluting the air for \$100 million. But because there are so many polluters and pollutants, voluntary transactions are prohibitively costly. One way to look at this case would be to say that clean air is not really worth \$900 million (benefits minus costs), because we have left out the transaction costs. These transaction costs, which exceed \$900 million, are just like any other costs—like transportation costs, for example—and, when added in, show that the clean air really has no net value.

Transaction costs differ from transportation costs, however, because they sometimes can be circumvented by substituting a legal institution for the market as the method of allocating resources. In deciding whether this is possible in a particular case, we must have an idea of the value of an allocative change without regard to transaction costs, before we can decide whether that value exceeds the cost of the legal institution necessary to bring about the allocation.¹⁰ If, in my example, the institution would cost less than \$900 million, then society would be made wealthier by the legally coerced allocation of the rights in the air to the victims of the pollution. But \$900 million may be an underestimate. Recall that asking prices can exceed offer prices. It might be that although the victims of air pollution would be willing to spend only \$1 billion for cleaner air, once they had cleaner air they might demand \$2 billion to give it up. This would be the relevant figure if the victims were deemed to own clear air, rather than if the polluters owned the right to dirty the air; and, precisely since asking and offer prices may differ,¹¹ and differ greatly, this assumption may affect the outcome of the hypothetical transaction—an important point to which I shall return in a moment. If the cost of abating pollution was \$1.5 billion, the difference between deeming the victims the owners of the right and deeming the polluters the owners of the right would be crucial.

10. Thus the social engineer is interested in the value of a transaction ex transaction costs in the same way that a transportation engineer is interested in the value of a transaction ex transportation costs.

11. For empirical evidence, including evidence on air pollution, see Knetsch, *Legal Rules and the Basis for Evaluating Economic Losses*, 4 INT'L REV. L. & ECON. 5 (1984).

But the present point is simply that, given well-defined property rights, the question of whether wealth maximization concerns offer prices or asking prices is a pseudo-question. Wealth is maximized by creating a system which allows offer and asking prices to be compared, and offers to be accepted if, but only if, the offer price exceeds the asking price, and which imposes acceptance if, but only if, transaction costs make it impossible for the market to compare a (higher) offer price with a (lower) asking price, as in the pollution example.

Because asking and offer prices may differ, it is necessary to have a way of deciding who may charge an asking price and who must make offers; this is a question about property rights. For present purposes, a property right means the right not to be divested of the use, control, and enjoyment of a thing (tangible or intangible) at a price below one's asking price. Once property rights are assigned, it becomes clear who may charge asking prices and who must make offers. Wealth maximization can then proceed through the operation of the free market, and through market surrogates where the costs of market transactions are prohibitive and the costs of legal transactions tolerable.

It would, of course, be possible to take the assignment of property rights as given, and use wealth maximization to guide the shifting of the rights through trade and substitutes for trade. But I think one can go further and without circularity, can suggest how property rights should be assigned in the first place in order to maximize a society's wealth. And this is not so academic an endeavor as it may seem.

In my pollution example, there is no "natural" assignment of property rights over the use of the air; one could say that people have a right to breathe clean air, and polluters must buy that right, or equally that polluters have a right to emit pollutants as a byproduct of their activities, and people must buy that right (the "purchase" in either case would be an involuntary transaction, because market transactions are assumed to be unworkable). I do not know how to solve this particular problem; that is, I do not know whether in determining how much pollution is optimal we should use the asking or offer prices of clean air, which may of course differ, though presumably by little if we are talking about small changes in the cleanliness of air. If we are talking about whether the air shall be breathable or lethal, the difference between asking and offer prices could be enormous, since offer prices are limited by one's wealth, and asking prices may be infinite when the asker's life is at stake. However, cases of

this kind—where wealth maximization provides no guidance to the initial assignment of property rights *and* asking and offer prices are likely to differ greatly—are rare; they reveal a limitation to an ethics of wealth maximization, but not a fatal limitation.

One can say a good deal about how property rights should be assigned in order to maximize wealth. For example, wealth maximization does not imply assigning property rights to whomever, regardless of his budget, gets the most pleasure out of the property in question, though he might have the highest asking price.¹² This approach appears to collapse wealth maximization into utility maximization in the sense used by utilitarian philosophers; worse, it actually dis-serves wealth maximization. If property rights were assigned on the basis of who would charge the highest asking prices, society would soon be impoverished. The method of assignment would destroy incentives to work and invest—unless rights could be sold free of any governmental power to take them away from their new owner; but that would depart from a system of assigning property rights so as to maximize utility in the utilitarian sense.

Bear in mind that wealth is a stock concept, not a flow concept; one's wealth is the present value of the stream of future income or other benefits generated by one's human and physical capital. The stream would be pitifully small if property rights were assigned and reassigned on the basis of who derived the most pleasure from having what property. People would cultivate the faculty of enjoyment rather than of hard work; little producer and consumer surplus would be created.

If you asked a random group of economists how to assign property rights in a new society with a literate population so as to maximize the prices (times quantities), explicit and implicit ("shadow"), asking and offer, in the society, they would almost certainly begin by giving each mentally competent adult the property rights to his own labor.¹³ They would, in short, reject slavery, an inefficient institution under modern conditions. With unimportant exceptions, the costs of moni-

12. Might, not would, because if he also got great pleasure out of other things, the money he could get for a given item of property might be very valuable to him because it would enable him to buy other pleasurable things.

13. The qualification implies, of course, the persistence of institutions of quasi-slavery, as one might characterize (but for the pejorative overtones) the condition of children and mental incompetents.

toring the output of a slave today would be much higher than the costs of monitoring a free man's output through contract. Although some slave owners would be quite wealthy, the society as a whole (which includes the persons who have been made slaves) would be poor. Society's wealth would be eaten up to a great extent by "agency costs." Arguably, this, rather than moral progress unrelated to material conditions, may be the main reason that slavery is no longer a common institution.

I recognize that some will count it a very great defect of my ethical system that it does not condemn slavery as always and everywhere bad. But partly, this is just a reaction to a word that has intensely pejorative connotations. Is it "slavery" to make a prison inmate work? Was indentured servitude, whereby immigrants to this country in the colonial period got their passage paid in exchange for becoming indentured servants for a period of years, "slavery," and therefore, bad? Was it an advance or retreat of civilization when victorious tribes began enslaving rather than killing the male population of the vanquished group? The answers are not so clear as to justify a blanket condemnation of all forms of involuntary servitude.

With natural resources, the initial assignment of property rights is not critical because presumably whoever gets the rights will sell or rent them to those who can get the most value out of them. The problem of the discrepancy between offer and asking prices will not be important here, because resources whose only use is "utilitarian" in the lay sense will tend to be valued at very near the market price. But this happy picture ignores important sources of friction. In particular, those who in the initial distribution receive no rights in natural resources will, in order to buy from those who do, have to borrow against inherently uncertain prospects. The same uncertainty makes it hard for the society to assign the property rights at the outset to those who can get the most value from them. Perhaps the best that can be done is, as in the nineteenth-century Homestead Acts, to parcel out the rights in an egalitarian fashion. This will give everyone some physical capital and therefore make it easier for the able and ambitious to rise.

An important application of this point suggests that the implications of wealth maximization are not entirely "illiberal," as those who deride it as capitalist ethics—which it is—may think. The maximization of wealth requires that people with productive potential have opportunities to de-

velop that potential. This in turn requires means to identify such people and enable them to rent the tools they need to realize their potential. Because the potential of young children is not apparent unless they are given educational opportunities, and because it is difficult to borrow against one's future earnings (because the loan can be enforced only by making the borrower the lender's slave if he defaults—creating all the agency-cost problems of slavery), there is a solid argument based on wealth maximization for subsidizing education, especially (though not only) for the poor. The argument, however, need not imply government operation as distinct from financial support of the schools.

After rights are assigned, the free market can be relied on to reallocate them from time to time to those who value them the most as shown by willingness to pay an offer price equal to the current owner's asking price. Problems of monopoly, the needs of public finance, the problem just discussed of financing investments in human capital, external benefits and costs associated with such phenomena as charity (a source of external benefits) and crime (external costs), and concerns with political stability will require, however, some redistribution through the tax and government expenditure system. In short, a lightly regulated capitalism starting from conditions of broad equality will maximize a society's wealth. The history of this country, and, more generally, a comparison of capitalist and noncapitalist societies, illustrate the benefits of light regulation though it is no longer possible to describe our capitalism as lightly regulated.

B. *The Instrumental Character of Wealth Maximization*

I am reasonably satisfied that the objection based on the fact that wealth cannot even be measured unless property rights are first assigned can be met to the degree required in ethical discourse. I now move on to a second and more serious objection, which is that the ethic of wealth maximization rests on air. One does not value wealth for itself but for something else, and once we identify the something else, we can orient our social institutions toward accomplishing that end and cease pursuing the merely instrumental goal of maximizing wealth.

The values which provide the underlying ethical appeal of wealth maximization pull us in two seemingly opposite directions: toward utilitarianism and toward individualism. Wealth maximization promotes prosperity, and prosperity

(not always but usually) engenders happiness. Wealth maximization also protects individual rights, and therefore promotes individualism. But, presumably, wealth maximization promotes each of these desiderata (particularly the second) to a lesser extent than a philosophy aimed directly at either one of them would do—a point that will now be illustrated and evaluated.

1. Wealth and Happiness

It is easy to think of examples where wealth maximization is at least superficially opposed to utilitarian goals—though, as the examples are rather extreme, maybe they should not trouble us much. But set aside that point and suppose as an example that a quantity of pituitary extract is being auctioned off. There are two bidders: one is a poor family whose child will be a dwarf unless he gets the extract; the other is a wealthy dilettante who wants to use the extract to grow a giant gerbil. The dilettante is the high bidder (let us assume away any imperfection in capital markets by supposing that even if the family could borrow against the child's future earnings, its offer price would still be lower than the dilettante's).

The result of wealth maximization in this case seems clearly contrary to the dictates of utilitarianism, besides being quite offensive. Yet these reactions may be superficial. We must consider, for example, who will get the pituitary extract if the dilettante is forbidden to buy it. More important, we must consider that, in the long run, there may be more and cheaper pituitary extract, and fewer dwarves, if the society does not try to allocate the product to those who will derive the greatest happiness from it. Or people may be sufficiently altruistic, even toward strangers, to support, as a component of the government's tax and expenditure system, a program for buying pituitary extract at market prices and giving it to children whose families are unable to afford it. Reliance on private charity may seem an obvious alternative to a public program but might not be efficient because of a free-rider problem. If I want fewer dwarves, I will benefit from your charitable contribution as much as you do, without having to make a contribution myself. The result will be a lower level of contributions than most people desire and, in the absence of free-rider problems, would make. This is an inefficient result which, in principle anyway, justifies government intervention even in a society dedicated to wealth maximization.

The real divergence between wealth maximization and utilitarianism occurs where utilitarianism is contrary to virtually everyone's moral intuitions. Suppose someone has such a well-developed sense of pleasure that he receives twice as much pleasure from a dollar than one who happens to be frugal and self-denying. Is that a reason for transferring a dollar from the second to the first person? A utilitarian would have to say it was a reason, although it might well be outweighed by the adverse effect on happiness in general if people's wealth were up for grabs in this way. Even worse, suppose a sadist got more pleasure from hurting people than his (involuntary) victims suffered pain; the sadist's conduct would be happiness-maximizing, and therefore good.

Utilitarianism makes the individual an input into the achievement of an aggregate quantity, the total happiness in society. This fact is the dark side of the most attractive feature of utilitarianism—its tolerance for different conceptions of the good. Somehow utilitarianism manages to be both radically individualistic and shockingly communitarian. It is so individualistic in its premises that it gives the same status to the sadist and the pleasure-loving scamp, on the one hand, as to the heroic physician or brilliant engineer on the other. At the same time, it is so aggregative that it invites us to consider the possibility of redistributing wealth and power from the productive and hard-working and self-restrained to people of unbridled appetites and vicious disposition.

What is missing from utilitarianism is any very direct concern with the productive side of human activity; all the focus is on the consuming, the appetitive. Perhaps this matters little in practice, because consumption is dependent on production, and the pleasure-loving will have few pleasures in a society that does not give its members incentives to produce. Indeed, the pleasure-loving might work particularly hard in order to get control of the resources that they need in order to maximize their pleasure and might support institutions that reward productive people. Nonetheless, it seems odd to give consumption moral precedence over production, to sacrifice the frugal for the pleasure-loving.

Wealth maximization reverses the order, and this is a mark in its favor. In a society dedicated to wealth maximization, the power to consume is limited by the ability to obtain claims on resources, and this ability depends on the production of goods or services that others value in trade. This is true even when the consumer is spending inherited money, as might have been the case with our wealthy dilettante buying

pituitary extract for his gerbil. A person who accumulates more money than he spends during his lifetime is, in effect, deferring some of his spending until after his death, when it will be done by surrogates, his heirs. In deciding how much to accumulate and how much of that accumulation will go to his heirs rather than to charity, the testator will take into account the likelihood that his heirs will spend the money he leaves them in foolish or offensive ways. If, after taking this possibility (a form of "agency cost") into account, he nevertheless leaves them money, they become, in effect, his agents to spend it after his death. Any interference with their expenditures is an interference with his disposition of assets accumulated through his productive efforts.

Granted, he may not have accumulated his wealth by productive efforts; he may have stolen the money, or obtained it by monopolization, or inherited it from someone who had stolen it. These would be grounds for interfering with its expenditure in the next generation according to the testator's wishes. But if all illegitimate (i.e., unproductive) sources of wealth are assumed away as incompatible with wealth maximization, then in a society dedicated to wealth maximization, the right to consume will depend on productive activity.

To defend wealth maximization rigorously, it would of course be necessary to assign some ethical value to productivity. That would not be difficult but will not be attempted here. Although there is some well-merited skepticism about various aspects of modern life, very few people who live in wealthy societies would like to live in poor ones; and very many people who live in poor ones would, if allowed, move to wealthy ones. So there seems to be something good in a practical sense about wealthy societies, unless you think (as few economists do) that wealthy societies have become wealthy by exploiting poor ones. And if there is something good about wealthy societies, there must be something good about the people who make societies wealthy—and they are not the hedonists and the sybarites but the frugal and the hard-working. It is curious, but true, that to aim directly at maximizing happiness, by distributing and redistributing wealth to those who would get the most pleasure from it, is self-defeating because it results in a poor and unhappy society. Wealth maximization is a more effective instrument for attaining the goals of utilitarianism than utilitarianism itself. Stated otherwise, wealth maximization is the correct rule of decision in a system of rule utilitarianism.

Wealth maximization does not completely exclude governmental redistributions of wealth, as we saw in discussing the free-rider problem that depresses private charity. But it authorizes only those redistributions that conform to the altruistic feelings that most people harbor or that otherwise serve the interests of the productive people in the society. The free-wheeling redistributions of a utilitarian society are ruled out. This is also a mark in favor of wealth maximization.

A further criticism of wealth maximization that I will merely note and not try to answer is that, like utilitarianism, it assigns too much weight to individual preferences. Compare the sadist who assaults an involuntary victim and a sadist who obtains equivalent satisfaction from a mutually voluntary transaction with a masochist. The two sadists have similar standing in a system unflinchingly dedicated to maximizing happiness, provided that in the first case the sadist's pleasure exceeds his victim's suffering; but in a system of wealth maximization, the second sadist is a distinctly better man. The successful producer of an infantile television show who earns \$500,000 a year would, in a system of wealth maximization, be counted as a better, more productive person than a laborer who earns \$10,000. But the producer may not be more productive than a scientist who earns only \$50,000, as the scientist may confer large external benefits on society, that is, benefits that he does not capture in a higher income for himself.

2. Wealth and Individual Rights

If wealth maximization has affinities with utilitarianism, it also has affinities with the individualist political philosophy that has been made respectable among professional philosophers in recent years through the work of Robert Nozick—though it has antecedents in the writings of Hobbes, Locke, Kant, Jefferson, and other classic expositors of Western liberalism. The premise of individualist political philosophy is that a person is defined by the possession of faculties such as reason and of rights thought appurtenant to the possession of such faculties. The conclusion is that the role of the state is to protect those rights, including the right to engage in voluntary exchange. In wanting to protect voluntary exchange, the individualist philosopher comes close to being a wealth maximizer. But he may also deduce rights that may be inconsistent with wealth maximization, as in Professor Ep-

stein's suggestion that individualism implies that tort liability to strangers should be strict liability, even if negligence liability (or no liability) would be more efficient. In Epstein's view, if you run someone down, you must pay his damages because you have invaded his rights, even if you were faultless in the sense of being unable to avoid the accident at reasonable, perhaps at any, cost.¹⁴

A counterargument is possible, however.¹⁵ If negligence is really cheaper than strict liability, then the sum of accident (first-party) and liability (third-party) insurance costs will be less under negligence than strict liability, and all drivers will prefer the former. Hence, negligence liability can be derived by a hypothetical voluntary transaction, which is a standard method of justifying institutions in an individualist philosophy. Stated differently, if a change (say from strict liability, assuming that is the regime initially deduced from individualist premises, to negligence liability) makes everyone better off by his own rights, it is hard to see it as trammeling anyone's individual rights. And if we are reasonably confident that the change would be adopted unanimously if we could somehow put it to a vote, this ought to come close enough to real (expressed) unanimity to satisfy the claims of individualism—as should also, I would contend, near unanimity, provided that the sacrifice by the opponents is a very small one in both an aggregate and an individual sense. That is, if ninety-five percent of drivers would have much lower insurance rates from a switch to a negligence standard, and none of the other five percent would pay more than a few dollars a year in additional premiums, it would be hard to condemn the change on individualist grounds without being accused of fanaticism.

C. *The Problem of Inalienable Rights*

Some implications of individualism, however, are quite hard to reconcile with wealth maximization, and these deserve separate consideration. Almost everyone writing in the individualist tradition thinks slavery improper even if the slave became such through a voluntary transaction, as in contracts of indentured servitude, which, as I mentioned, were common in eighteenth-century America—though most individualists will make a narrow and partial exception for mili-

14. See Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973).

15. For a slightly fuller treatment of this point, see R. POSNER, *supra* note 1, at 94-99.

tary service. Torture and lynching are other examples where the individualist will be inclined to say that the practice violates essential personhood even if it could be shown to maximize wealth, as it could be in the (far-fetched) example where a person is lynched in circumstances of absolute certainty that he is guilty and that the legal punishment would have been death if he had stood trial. In this case, the only effect of lynching is to reduce the costs of administering the legal system. A somewhat more plausible case is eliminating the privilege against self-incrimination, to make everyone (or nearly everyone) better off *ex ante*, by increasing the probability of convicting guilty people. The feeling against these practices runs very deep in our culture. It is bound up with a general aversion to cruelty that dates only from the humanitarian movement of the nineteenth century; yet Hobbes, who emphatically supported the privilege against self-incrimination,¹⁶ was a man of the seventeenth century—and no softy.

Long after lynching, slavery, and torture were all thoroughly reprobated, it still would not have been thought unjust for the state to allow a man to starve who could not earn a subsistence income by his best efforts. Today it would be thought unjust, though not by all individualist philosophers in the sense in which I am using the term. There is for good or ill nothing in the ethic of wealth maximization which says that society has a duty to help the needy. It has a duty not to hurt them, to leave them alone; but it has no duty, and in a strict ethic of wealth maximization no right, to force the productive people to support the unproductive. Being needy does not establish a claim. A right implies a duty; and there is no basis in a system of wealth maximization for implying a duty to help someone you have not hurt. Charity is an important part of personal ethics, but except where the charitable impulse is impeded by free-rider problems, a political duty of charity cannot be deduced from the premises of wealth maximization. In this regard, wealth maximization is at one with individualist political philosophy, but both are out of phase with powerful currents of contemporary moral feeling; both, perhaps, neglect the role of luck in wealth and poverty and by doing so give excessive moral status to the condition of being a productive person.

All of the examples I have discussed are sufficiently troublesome to make me regard wealth maximization as an incomplete guide to social decision-making. But within the

16. See, T. HOBBS, *LEVIATHAN*, pt. 2, ch. 21 (London 1651).

broad limits indicated by these examples, wealth maximization does provide a reasonable guide to social decision-making and, in particular, builds a bridge between utilitarian and individualist philosophies—and not an adventitious bridge, either. Wealth maximization shares with utilitarianism an emphasis on the moral value of individual preferences and desires, and with individualism a hostility to coercion.¹⁷ It does not banish coercion entirely, because where market transaction costs are prohibitive, wealth maximization allows, and indeed requires, the state to use its powers to mimic the market—if this can be done at a cost lower than the gain in value brought about by the market-mimicking transaction. But the limited forms of coercion that are legitimate in a system of wealth maximization promote social welfare so broadly that they can be deemed to command almost universal consent. The institutions of criminal, property, tort, and contract law—indeed of common law in general—are of this character.

The strong hold that both utilitarianism and individualism have over American social thought suggests that a political philosophy which draws on both may command a broader support than either. The pluralistic and—let us face it—materialistic character of our civilization makes it inevitable that government will and should try to promote the greatest happiness of the greatest number, rather than decide what preferences are legitimate and whose preferences should count the most. But pushed to an extreme, utilitarianism creates a potential for wealth redistribution that is inconsistent with a commitment to individual autonomy (as illustrated by the claims of the “utility monster” to have wealth redistributed to him because he is especially efficient at processing it into happiness, though only his own). Yet too rigid a commitment to individual autonomy would diminish the happiness of the society to an intolerable extent—a point with many potential illustrations from the writings of Kant and his followers, including Rawls, who to maximize the position of the least fortunate would be willing to impose enormous sacrifices on the rest of the society.¹⁸

17. The civilizing influence of capitalism—and what is wealth maximization but the ethics of capitalism?—is emphasized in Haskell, *Capitalism and the Origins of the Humanitarian Sensibility* (pts. 1 & 2), 90 AM. HIST. REV. 339, 547 (1985).

18. See, e.g., J. RAWLS, A THEORY OF JUSTICE 152-54 (1971); ARROW, *Some Ordinalist-Utilitarian Notes on Rawls's Theory of Justice*, 70 J. PHIL. 245, 251 (1973); Hodges, *Punishment*, 18 PHIL. & PHENOMENOLOGICAL RESEARCH

Wealth maximization perhaps comes up short by not recognizing either inalienable (i.e., nonsalable) rights—a deficiency (if it is a deficiency) that it shares with utilitarianism—or claims to public assistance—a deficiency, in terms of contemporary intuitive morality, that it shares with individualism. In a system of wealth maximization, the needy (dramatically including the child in my pituitary-extract example) have no right to coerce even minimum assistance. Yet this characterization of wealth maximization is only approximately true. It would be more accurate to say that wealth maximization reflects the distributive preferences of the people who produce the wealth of the society. To the extent that such people are altruistic, but the full expression of their altruism is frustrated by free-rider problems, government is authorized (indeed, required) to undertake redistributive efforts. If altruistic feelings were not widespread, philosophers would not consider a political philosophy that made no room for the hard-hearted rather than hard-headed. To the wealth maximizer, altruism is neither good nor bad; but given that it exists, there is a legitimate if limited role for public wealth redistribution. If altruism did not exist, the absence of such redistribution would not be felt to be unjust.

It must also be emphasized that it is a *political* philosophy that I am expounding. You may be a bad person if you are selfish; but it may not be the proper role of the state to change your values and preferences.

III. APPLICATION TO LAW

Despite all I have said, or perhaps because of some of what I have said, I am sure that many of my readers will continue to regard wealth maximization as a dubious guide to social decision-making in general. But the case for using it to guide courts, in areas where the Constitution or legislation does not deprive them of initiative or discretion in the matter, is a powerful one—though with some limitations along the lines suggested above.

The legal profession long pretended that with unimportant exceptions, discretion—power—was something that bad judges seized, while good judges deduced the outcomes of their cases from rules laid down by higher or prior courts, legislatures, and the framers of the Constitution. Today, however, it is generally recognized that even the best judges

cannot decide difficult cases simply by deduction from premises found in authoritative sources of legal guidance (which is why the cases are called difficult)—that they have and must exercise substantial discretion. The question arises, in what frame of reference should that discretion be exercised? Pragmatic? Utilitarian? Christian? Darwinian? Rawlsian? Nozickian? I suggest that wealth maximization provides the most acceptable frame of reference. I shall not attempt to argue this position fully here but will content myself with the following rather summary points:

1. Wealth maximization combines, as I have said, elements of utilitarianism and individualism, and in so doing comes closer to being a consensus political philosophy (I do not suggest it is one) in our contentiously pluralistic society than any other overarching political principle. This point is concealed by the fact that the term "wealth maximization" is not a term in common usage. It would be easy to show, however, that many invocations of fairness and justice, "balancing" and due process and other familiar principles or methods of judicial decision-making are proxies for wealth maximization.¹⁹

2. The principal complaint likely to be leveled against wealth maximization as a guide to judicial action is its lack of a strong redistributive component; as we have seen, it validates some redistribution of wealth from rich to poor but much less than is desired by many reflective and influential students of social justice. Any possible collisions between wealth maximization and the strong modern feelings against slavery, lynching, and torture, however, are made moot by the constitutional prohibitions against these practices.²⁰

Given the absence of anything approaching a consensus on the optimum distribution of wealth, however, it is very hard to see how courts could adopt a redistributive ethic to guide their decisions. For this and another reason—that courts do not have flexible instruments for redistribution compared to the (overtly) taxing, spending, and regulatory branches of government—a sensible division of labor has the

19. This is a major theme of my book, R. POSNER, *ECONOMIC ANALYSIS OF LAW* (2d ed. 1977); the forthcoming third edition will be published in March, 1986.

20. The Thirteenth Amendment forbids slavery; the due process clauses of the Fifth and Fourteenth Amendments forbid lynching; the Fifth Amendment forbids torture to obtain incriminating evidence; and the Eighth Amendment forbids torture as a method of inflicting punishment on convicted criminals.

courts focus on wealth maximization (making the pie as big as possible) while legislatures focus on redistributing some of that wealth (reslicing the pie).

My interest in wealth maximization grew from and remains centered upon its role, both actual and desirable, in guiding judicial decision-making in "common law" areas, broadly defined to include any field where judge-made law is important; where judicial discretion—lawful and legitimate judicial discretion—is important. By a happy coincidence, as I have said, many of the questions on which the unflinching embrace of the implications of wealth maximization might yield results contrary to widespread moral intuitions, such as lynching and torture, have been taken out of the area of judicial discretion by constitutional provisions. The domain in which wealth maximization is allowed to operate in the law is, not surprisingly, the domain in which the principle of wealth maximization—once it is correctly understood, and not confused with the ethics of Mammon or Midas—expresses fundamental values of our political culture.

